REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

THE DEPARTMENT OF INSURANCE SHOULD BE MORE RESPONSIVE TO CONSUMER COMPLAINTS AGAINST THE INSURANCE INDUSTRY

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Auditor General

May 12, 1986 P-575

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Department of Insurance (department). The department has been slow in processing consumer complaints against the insurance industry and has not provided enough telephone access for the general public. Furthermore, the department did not effectively use consumer complaints to review insurance companies.

We conducted this audit to comply with Chapter 527, Statutes of 1985.

Respectfully submitted,

THOMAS W. HAYES
Auditor General

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SUMMARY

The State of California will spend approximately $24.7 million to operate the Department of Insurance (department) in fiscal year 1986-87. The department is administratively responsible for regulating the insurance industry and for protecting policy holders in California. To protect policy holders, the department receives and processes consumer complaints filed against the insurance industry, which earns $30 billion in premiums annually. However, the department has been slow in processing these complaints and has not provided enough telephone access for the general public. Furthermore, the department did not effectively use consumer complaints to review insurance companies.

Consumer Complaints Are Processed Slowly

In fiscal year 1984-85, the department was slow to process at least 7,025 (51 percent) complaints filed with the department's Consumer Affairs Division. We considered complaints to be slowly processed when the department's staff did not meet the department's standards for processing the complaint promptly. The average time to process these complaints was 89 days. Delays in processing complaints occurred in each phase of the complaint investigiation--acknowledging the complaint, notifying the insurance company, and resolving the complaint. As a result, the public did not receive prompt protection from unfair insurance practices. When the complaints involved premiums or claim disputes and the insurance industry acted improperly, the complainants incurred economical losses. For example, a consumer filed a complaint with the department because neither her medical insurance company nor her workers' compensation insurance company would pay $1,600 for medical treatment. Finally, 102 days from the date the department received the complaint, the consumer received the $1,600 to pay for the medical treatment.

In addition, as of December 31, 1985, the department's Investigation Bureau had not investigated 367 (32 percent) of 1,151 complaints. This backlog of complaints involved allegations of economic loss and emotional distress caused by fraud, misrepresentation, dishonesty, incompetence, and other illegal acts. Of these complaints, 135 (37 percent) were over one year old, and 44 (12 percent) were over two years old. Yet the Investigation Bureau still has not investigated these complaints. In addition, the Investigation Bureau assigned a high investigative priority to 35 percent of the backlogged complaints, but these complaints also have not been investigated. The department should investigate complaints promptly to ensure that it can acquire the proper evidence to pursue the appropriate legal action and to be effective in protecting consumers against improper insurance practices. For example, the Investigation Bureau had not investigated a complaint alleging that an insurance agent issued invalid insurance policies to a consumer who paid his premiums in good faith. However, after the consumer suffered a loss of $14,000, the insurance company informed him that he did not have insurance coverage.

In addition, consumers have limited access to the department because existing telephone lines are often busy. During a one-week period in March 1986, consumers received busy signals over 7,000 times when attempting to telephone the department. In addition, the department does not have toll-free telephone lines for consumers to use to call the department for assistance. Consequently, consumers have difficulty contacting the department to request assistance in resolving their insurance problems. Increasing the number of telephone lines would allow the department to receive more complaints and to determine if additional staff are needed to process those complaints. By assisting more consumers, the department could recover from insurance companies more funds for the public.

Ineffective Review of Insurance Companies

The department is not effectively using consumer complaints to review insurance companies. The California Insurance Code authorizes the department to conduct reviews of insurance companies when necessary. The department's Market Conduct Bureau did not effectively review insurance companies. For example, since 1984, the Market Conduct Bureau reviewed one of ten companies with an improved complaint record; consumers filed 10 percent fewer complaints against this company than had been filed in 1983. Also, since 1984, 36 other insurance companies with worse complaint records were not reviewed. Furthermore, the Market Conduct Bureau continued to conduct comprehensive reviews of five of the ten companies even though it found no deficiencies in these companies. The bureau also did not coordinate its reviews with the department's Field Examination Division.

In January 1986, the department issued a report ranking automobile insurance companies using the complaint information. The report was the department's first effort to provide the public with meaningful complaint information on automobile insurance companies. The department issued the report under the authority of the California Insurance Code to provide education and to disseminate information to the public. However, the report contained inaccurate and incomplete data that resulted in incorrect rankings for automobile insurance companies. For example, the ranking of companies with premiums under $500 million would change significantly if the errors were corrected. The department's report was incomplete because the department omitted companies with fewer than three complaints.

Corrective Action

The department has taken corrective action to investigate complaints more promptly. Since July 1985, the department appointed three new managers in the Consumer Affairs Division. In addition, the Consumer Services Bureau instituted a review of complaint investigations to ensure that its staff are processing complaints promptly. The Rate Administration Bureau obtained additional staff to process the increasing number of complaints and established procedures to monitor each worker's caseload. In addition, to improve the operations of the Market Conduct Bureau, the department consolidated the Market Conduct Bureau and the Policy Services Bureau.

INTRODUCTION

To protect California's insurance policy holders, the Department of Insurance (department) regulates insurance companies, agents, and brokers, who earn premiums of approximately $30 billion annually. The department is responsible for enforcing the requirements of the California Insurance Code, which prohibits unfair methods of competition or unfair or deceptive insurance practices. As defined in the California Insurance Code, unfair insurance practices include misrepresenting insurance coverage, failing to act promptly on insurance claims, failing to settle an insurance claim fairly, and failing to provide an explanation for the denial of a claim. To prevent unfair insurance practices, the department investigates complaints filed by consumers against insurance companies, agents, and brokers.

The majority of these complaints are investigated by the department's Consumer Affairs Division. During fiscal year 1984-85, the Consumer Affairs Division received over 93 percent of the total of 14,725 complaints filed by consumers. Three bureaus within the Consumer Affairs Division investigate consumer complaints. The Policy Services Bureau in fiscal year 1984-85 received 9,675 complaints including unsatisfactory claims settlements, delays in paying claims, and the failure to pay claims. The Consumer Services Bureau in fiscal year 1984-85 received 2,750 complaints about insurance billing problems and disputes related to the consumer's insurance policy. The Rate

Administration Bureau in fiscal year 1984-85 received 1,300 complaints involving workers' compensation and changes in premium rates.

Finally, the Market Conduct Bureau in the Consumer Affairs Division reviews insurance companies to determine if their general business practices are conducted in accordance with the California Insurance Code. The Market Conduct Bureau uses complaint information on insurance companies to select companies that it will investigate. The Market Conduct Bureau analyzes insurance companies' procedures to determine if claims are paid promptly.

In addition to the Consumer Affairs Division, the department's Investigation Bureau investigated consumer complaints involving allegations of economic loss and distress caused by fraud, misrepresentations, dishonesty, incompetence, and other illegal acts. As of December 31, 1985, the Investigation Bureau had 1,151 pending complaint investigations.

Budgetary Information for
Fiscal Year 1986-87

The department is financed by insurance company license fees, penalties, and examination and other fees. In the Governor's proposed budget for fiscal year 1986-87, the department estimates that revenues will be $26 million.

The total expenditures proposed for fiscal year 1986-87 will be approximately $24.7 million; proposed expenditures for personal services will be approximately $17.6 million for 414 authorized positions. Included in the proposed expenditures are $3.4 million for 74 positions in the Consumer Affairs Division and $2.4 million for 45 positions in the Investigation Bureau.

SCOPE AND METHODOLOGY

The purpose of this review was to determine the department's effectiveness in processing consumers' complaints and in using complaint statistics. We conducted this audit to comply with Chapter 527, Statutes of 1985, which requires the Auditor General to evaluate the effectiveness of the Department of Insurance's administration of those provisions of the California Insurance Code related to unfair claims practices and late payments of claims.

In the Consumer Affairs Division, we reviewed 391 complaint files, opened in fiscal year 1984-85, to determine if the department processed the complaints promptly, and we statistically estimated the number of complaints that the department did not process promptly. In the Investigation Bureau we looked into the backlog of unassigned and uninvestigated complaints as of December 31, 1985, to determine how long the complaint had not been investigated and the investigative priority assigned to the complaint. To determine the department's accessibility to consumers, we reviewed the department's telephone

system and a telephone company study that monitored the busy signals on consumer lines. We also investigated the possibility of the department using toll-free lines.

To evaluate the reports prepared and examinations based on consumer complaint data, we reviewed the selection procedures and examination process of the Market Conduct Bureau. We also reviewed the department's report on the ranking of automobile insurance companies to determine the accuracy of the rankings.

CHAPTER I

THE DEPARTMENT OF INSURANCE'S PROCESSING OF CONSUMER COMPLAINTS

During fiscal year 1984-85, the Department of Insurance (department) was slow to process consumer complaints against insurance companies, agents, and brokers. As a result, the public did not receive prompt protection from unfair insurance practices. Furthermore, when consumers filed complaints alleging fraud, misrepresentation, dishonesty, incompetence, or other illegal acts against the insurance industry, the department's Investigation Bureau did not promptly process the complaints, and a backlog of complaints developed.

In addition, consumers requesting assistance have limited access to the department. The department has an insufficient number of telephone lines and operators and no toll-free telephone lines to respond to telephone calls from consumers. As a result, the public cannot always contact the department for assistance.

During our review, the department began taking action to improve its processing of consumer complaints. Also, the department hired new management personnel for its Consumer Affairs Division (division).

THE DEPARTMENT OF INSURANCE WAS SLOW IN PROCESSING CONSUMER COMPLAINTS

Section 12921.3 of the California Insurance Code requires the department to accept complaints against the insurance industry from the public and permits the department to investigate these complaints. To ensure prompt investigation and resolution of complaints, the division established the following guidelines for its staff to use. First, the division requires its staff to acknowledge the complaint within ten working days from the date the complaint is received.* Second, the division requires its staff, within ten working days, to notify the insurance company of the complaint and to request from the insurance company the information necessary to resolve the complaint. Finally, the division requires its staff to act upon every pending complaint at least once every 30 days.

Slow Complaint Processing

During fiscal year 1984-85, the division was slow in processing at least 7,025 (51 percent) of the 13,725 consumer complaints filed against the insurance industry. We considered a

*Effective January 1, 1986, Section 12921.4 of the California Insurance Code (Chapter 1386, Statutes of 1985) requires the department to acknowledge the receipt of written complaints within ten working days after receipt of the complaint. However, the complaints we reviewed were received before the enactment of this legislation.

complaint to be slowly processed when the department's staff did not meet its guidelines for the prompt processing of complaints. The three bureaus that process complaints within the division were slow in processing complaint investigations. The following table shows the estimated number and the percentage of complaints that were processed slowly by the division and three of its bureaus.

TABLE 1

COMPLAINTS RECEIVED IN FISCAL YEAR 1984-85 THAT WERE PROCESSED SLOWLY BY THE CONSUMER AFFAIRS DIVISION

Bureau	Number of Complaints Received	Number of Complaints Slowly Processed	Percent of Slowly Processed Complaints
Policy Services	9,675	4,350	45
Consumer Services	2,750	1,800	65
Rate Administration	1,300	875	67
Total for the Consumer Affairs Division	13,725	7,025	51

The Policy Services Bureau was slow in processing at least 45 percent of its complaints. In addition, the Consumer Services Bureau was slow in processing at least 65 percent of its complaints while the Rate Administration Bureau was slow in processing at least 67 percent of its complaints.

In addition, delays in processing complaints occurred in all three phases of the complaint investigation--acknowledging the complaint, notifying the insurance company of the complaint, and resolving the complaint. The following table shows the estimated number and percentage of complaints that the department processed slowly for each phase of the complaint investigation. The percentages are based on the total complaints received during fiscal year 1984-85.

TABLE 2

COMPLAINTS RECEIVED IN FISCAL YEAR 1984-85 THAT WERE PROCESSED SLOWLY

Bureau	Notifying the Complainant		Notifying the Insurance Company		Resolving the Complaint	
	Number	Percent	Number	Percent	Number	Percent
Policy Services	725	7	775	8	3,450	36
Consumer Services	1,325	48	1,525	55	600	22
Rate Administration	300	23	N/A	N/A	775	60
Total for the Consumer Affairs Division	2,350	17	2,300	17	4,825	35

As Table 2 illustrates, the Policy Services Bureau notified complainants and insurance companies more promptly than the other two bureaus. However, the Policy Services Bureau delayed resolving at

least 36 percent of its complaints filed in fiscal year 1984-85. Often, the Policy Services Bureau's staff did not ensure that insurance companies promptly provided the information needed to resolve the complaint. The Consumer Services Bureau was slow in acknowledging consumer complaints and in notifying the insurance companies for approximately half of the cases filed. The Consumer Services Bureau was also slow in resolving at least 22 percent of its complaints. Although this percentage is lower than those of the other bureaus, the Consumer Services Bureau often took more than 60 days to complete an action, twice the amount of time permitted by department policy. The Rate Administration Bureau was slow to respond to complainants in at least 23 percent of the cases filed while it delayed resolving complaints in at least 60 percent of its cases. The Rate Administration Bureau often took over 60 days to complete actions in resolving complaints because it was slow to request information from the insurance companies and slow to ensure that the insurance companies responded.

The division took an average of 89 days to complete the complaint investigations in our random sample. Table 3 shows the length of time it takes each bureau and the division to complete complaint investigations.

TABLE 3

NUMBER OF DAYS THE CONSUMER AFFAIRS DIVISION TOOK TO COMPLETE INVESTIGATIONS OF COMPLAINTS FILED FOR FISCAL YEAR 1984-85

Number of Days	Number of Complaints: Policy Services Bureau	Consumer Services Bureau	Rate Administration Bureau	Total for Consumer Affairs Division
0 - 30	30	27	17	74
30 - 60	41	47	14	102
61 - 90	27	27	12	66
91 - 120	19	16	9	44
121 - 180	17	17	19	53
181 - 240	10	14	3	27
241 - 300	4		4	8
301 - 360		1	4	5
Over 361	1	3	—	4
Total Complaints	149	152	82	383

To obtain consumers' opinions on the department's processing of their complaints, we mailed a questionnaire to 400 consumers who filed complaints with the department in fiscal year 1984-85. We received responses from 237 consumers (59 percent). The results of the questionnaire on the department's processing of complaints are presented in Table 4.

TABLE 4

CONSUMERS' OPINIONS ON THE DEPARTMENT'S PROCESSING OF COMPLAINTS

Questions Asked	Responses		
	Yes	No	No Opinion
Did the department conduct its complaint investigations promptly?	69%	22%	9%
Was the consumer satisfied with the department's processing of the complaint?	52%	38%	10%
Would the consumer use the department to handle other complaints against insurance companies?	69%	17%	14%

Effects of Slow Investigations on Consumers

The department did not provide prompt protection to the public from allegedly unfair insurance practices. When the complaints involved insurance premiums or claims disputes and the insurance industry acted improperly, the complainants incurred economic losses. For example, the department received a complaint from a consumer stating that neither her medical insurance company nor her workers' compensation insurance company would pay for the medical treatment caused by an injury. Initially, the department acted promptly in acknowledging the complaint and in requesting from the medical insurance company the information necessary to resolve the complaint. However, the medical insurance company did not send the requested information within the required time, and the department did not follow

up with a second request to the company to obtain the information needed. Finally, the department received notification from the medical insurance company that it would pay $1,600 for the consumer's medical treatment. The department took 102 days to resolve the complaint.

In another case, the department received a complaint from a consumer stating that her insurance company would not pay for the psychiatric care her daughter needed after the daughter had attempted to commit suicide. The cost of the treatment was more than $10,000. Initially, the department acted promptly to resolve the complaint. However, the department inconvenienced the consumer by taking over 160 days to request a copy of the insurance policy. After reviewing the insurance policy, the department resolved the complaint by determining that the insurance company had acted appropriately.

In a third instance, on February 21, 1985, a complainant requested that the department determine why his workers' compensation insurance rate increased significantly. The department did not request from the insurance company the information needed to resolve the complaint until June 18, 1985, nearly four months after the receipt of the complaint. Since the insurance company did not respond to the department's inquiry, the department repeated its request for information. As of the end of March 1986, the department had not received a response from the insurance company, and the case was still open over one year after the complaint was initially filed. In this complaint, the department did not follow its own guidelines for

promptly processing the complaint, nor was the department effective in obtaining a response from the insurance company.

Reasons Complaint Investigations Are Not Processed Promptly

The department was slow to process complaint investigations because of a 44 percent increase in the number of complaints received, the lack of updated procedures manuals for staff to follow, inadequate supervision of the complaint process, and problems in routing complaints among the three bureaus.

The number of complaints that the department received in calendar year 1985 increased by 5,850 complaints (44 percent) from the previous year. The Policy Services Bureau received 11,500 complaints in 1985 compared to 10,225 in 1984, increasing each worker's caseload from 945 to 1,175 complaints per year. The Rate Administration Bureau received 1,800 more complaints in 1985 compared to 1984, representing an increase of over 200 percent. This increase in the number of complaints resulted in an increase of over 80 percent in the number of complaints in each worker's caseload. Finally, workers' caseloads in the Consumer Services Bureau increased from 475 complaints in 1984 to 700 in 1985. Department statistics show that the number of complaints is continuing to increase in 1986.

Furthermore, the department did not ensure that its bureaus had current procedures manuals for its staff to follow when

investigating complaints. For example, the Policy Services Bureau and the Consumer Services Bureau did not have up-to-date procedures in their manuals, and these two bureaus did not distribute the manuals to their respective staffs. Moreover, the Rate Administration Bureau did not have a procedures manual. Furthermore, the former bureau chief of the Consumer Services Bureau provided very little training to new employees for processing a complaint properly, resulting in the slow processing of complaint investigations by four new employees. Without updated manuals, the staff do not have uniform guidelines for processing complaint investigations and for promptly resolving complaints.

In addition to the increase in the number of complaints received and the lack of procedures manuals, the department's supervision of complaints was inconsistent and ineffective. For example, in fiscal year 1984-85, the department's management information system was unable to produce reports that would identify slow complaint investigations because the bureau had three different methods of numbering complaints. As a result, the former bureau chief in the Consumer Services Bureau was unable to determine why complaints were not being investigated promptly. In addition, the Consumer Services Bureau transferred complaint investigations between the San Francisco and Los Angeles offices for processing. This action caused further delays since the complaints did not receive prompt action at the new locations.

Moreover, three positions from other areas in the department were transferred to the Rate Administration Bureau, and the bureau hired one new employee to assist in processing the increased number of complaints. This resulted in delays in complaint investigations because the new staff needed training to become familiar with the investigation process.

The supervisors in the Policy Services Bureau inconsistently supervised the review of investigations. For example, one supervisor did not always review complaints that were not being processed promptly. The Chief of the Rate Administration Bureau also inconsistently supervised the processing of complaints. The bureau chief did not always monitor those complaints that needed action to assist their investigation.

Another factor that contributed to the slow processing of complaints was the incorrect routing of incoming complaints to the appropriate bureau for investigation. This situation often resulted in complaints being sent back and forth among bureaus with memorandums explaining why the complaints should be handled by another bureau. The incorrect routing of complaints caused delays in processing complaints from 5 to 60 days.

THE DEPARTMENT OF INSURANCE HAS A BACKLOG OF COMPLAINTS THAT HAVE NOT BEEN INVESTIGATED

Section 12921.3 of the California Insurance Code requires the department to accept and process complaints from the public. To be effective in protecting the consumer against improper insurance practices, the department should investigate complaints promptly. Furthermore, the department should investigate alleged misconduct promptly to ensure that proper evidence is available so that the department may pursue the appropriate legal action. Legal action could include revoking an agent's or broker's license to operate and imposing criminal sanctions for illegal activities.

Backlog of Complaints Requiring Investigation

As of December 31, 1985, the Investigation Bureau had accumulated 1,151 unresolved complaints. Of these, 367 complaints had not yet been investigated. Some of these complaints had been filed as far back as 1982. These 367 complaints involved allegations of economic loss and emotional distress caused by fraud, misrepresentation, dishonesty, incompetence, and other illegal acts. Further, the Investigation Bureau had not investigated 128 complaints even though they had been assigned a high priority for investigation. Complaints assigned an investigative priority of 1 or 2 represent a risk of financial loss to the public, have widespread impact on the public and the insurance industry, and create the potential for

disciplinary or criminal actions against the insurance industry. Complaints assigned an investigative priority of 3 or 4 represent a lower risk to the public. Table 5 presents by age and priority the number of complaints not investigated as of December 31, 1985.

TABLE 5

NUMBER OF COMPLAINTS NOT INVESTIGATED AS OF DECEMBER 31, 1985

Priority Number Assigned	Age of the Complaint (Months)							
	0-6	7-12	13-24	25-36	37-48	49-60	Over 60	Total
1	19	5	10	14	1	4		53
2	25	18	11	12	5	1	3	75
3	59	52	18					129
4	23	30	49	4				106
Unknown		1	3					4
Total Complaints	126	106	91	30	6	5	3	367

As the above table shows, the Investigation Bureau had not investigated 367 complaints, which represent 32 percent of the 1,151 pending complaints. In 44 of these cases, consumers filed complaints over two years ago. Also, complaints that the Investigation Bureau had assigned an investigation priority of 1 and 2 represent 35 percent of the bureau's backlog of 367 complaints. Complaints with investigative priorities of 1 or 2 that were filed over 24 months ago represent 11 percent of the Investigation Bureau's complaint backlog.

The Public Lacks Protection Against Improper Conduct

The public is exposed to a risk of economic loss and emotional distress when complaints are not investigated promptly. For example, a complainant alleged that his insurance agent issued him invalid insurance policies. He paid his insurance premiums in good faith. However, after he suffered a loss of $14,000, the insurance company informed him that he did not have insurance coverage. He filed his complaint with the department in January 1985, but the department had not investigated the complaint as of December 31, 1985.

The Investigation Bureau has assigned an investigative priority of 3 and 4 to 235 cases (64 percent of the total backlog). Although these complaints were assigned a lower priority for investigation, these complaints still represent serious allegations of misconduct and remain unresolved. For example, in February 1985, a consumer filed a complaint alleging that an insurance broker was paid $5,050 for insurance coverage but did not forward this money to the insurance company. Later, the complainant was notified by the insurance company that his insurance coverage was being cancelled for nonpayment. In another case, the complainant alleged that the agent altered a whole life insurance policy to shorten from eleven to five years the time needed to pay for the policy. Changing the number of years to pay for the policy on the policy holder's copy caused the full amount owed to appear to be $3,400 rather than $7,200, which was actually due.

Reasons for the Backlog of Complaints

A large backlog of consumer complaints has existed at the Investigation Bureau for several years. Both the department and the Investigation Bureau have taken actions to decrease the size of this backlog. These actions included transferring certain types of complaints to other units within the department and transferring certain investigative duties from investigators to noninvestigative staff. However, a large backlog of complaints still exists.

The high turnover of staff in the Los Angeles office has contributed to the large backlog of complaints that have not been investigated. Over 230 of these backlogged complaints (63 percent) are in the Los Angeles office. During 1984, the Investigation Bureau lost ten investigators in the Los Angeles office because they transferred to other state agencies or resigned. During that time, the bureau chief stated that the Investigation Bureau averaged three to five vacant positions per month. In addition, the Investigation Bureau hired 15 new inexperienced investigators. As a result, productivity in the Los Angeles office decreased.

In addition, as of December 31, 1985, the Investigation Bureau did not have an up-to-date list of backlogged complaints. Without such a list, the bureau is hindered in its ability to manage the backlog. For example, the Los Angeles office has complaints listed as backlogged; however, the office's staff were unable to locate eight

complaint files we requested. Finally, the office had complaints listed on the backlog that had been transferred to other offices within the department.

THE PUBLIC HAS LIMITED ACCESS TO THE DEPARTMENT OF INSURANCE

Section 12921.3 of the California Insurance Code requires the department to accept complaints from the public. To meet this requirement, the department operates telephone lines to receive complaints. The telephone is used by consumers over 50 percent of the time in contacting the department to request assistance. To be effective in assisting the consumer, the department must have sufficient telephone lines and operators to receive requests for assistance.

The Department's Telephone Lines are Busy

Pacific Bell reported that, during the five-day period beginning March 17, 1986, consumers received over 7,000 busy signals when calling the complaint lines in the Los Angeles office. Table 6 shows the number of busy signals received during the week of March 17, 1986, from the Los Angeles office.

TABLE 6

NUMBER OF BUSY SIGNALS RECEIVED BY CONSUMERS WHEN CALLING COMPLAINT LINES IN THE LOS ANGELES OFFICE DURING THE WEEK OF MARCH 17, 1986

Date	Number of Busy Signals Received
March 17, 1986 - Monday	1,842
March 18, 1986 - Tuesday	1,625
March 19, 1986 - Wednesday	1,656
March 20, 1986 - Thursday	990*
March 21, 1986 - Friday	896*
Total	7,009

*Pacific Bell's data for these days were incomplete.

Source: Pacific Bell survey of phone calls to the department.

Busy Telephones Limit the Public's Access

The department's ability to serve the public is impaired because the department's telephone lines are so often busy that some consumers may stop trying to reach the department. Increasing the number of telephone lines would allow the department to receive more complaints and to determine if additional staff are needed to process those complaints. By assisting more consumers, the department could recover from insurance companies more funds for the public.

To determine the extent of the difficulty in obtaining access to the department, we sent questionnaires to consumers who had submitted complaints to the department in fiscal year 1984-85. Forty-five of the 120 complainants who contacted the department by telephone said they had difficulty in reaching the department. For example, one complainant in San Diego reported that she had attempted to reach the Los Angeles office by telephoning the complaint lines five to six times, but only received busy signals. She stated that after she finally reached the department, she received the assistance that enabled her to obtain an insurance recovery of $1,850.

Reasons for Busy Signals

The department's telephone lines for receiving complaints are busy because the department does not have enough telephone lines and operators in its Los Angeles office. The department currently has three telephone lines with only one full-time and one part-time operator in its Los Angeles office and two lines in its San Francisco office with one full-time and one part-time operator. In 1985, the department handled over 100,000 calls.

Comparing the department to other state departments which receive complaints from the public, the department has fewer telephone lines and operators for the volume of telephone calls received. For example, in 1985 the Department of Housing and Community Development answered 48,000 telephone calls using at least four operators and five

telephone lines. In 1985, the Department of Justice answered nearly 35,000 telephone calls using from four to eight operators and five telephone lines. Again in 1985, the Bureau of Automotive Repair in the Department of Consumer Affairs answered over 200,000 telephone calls with five operators and five telephone lines.

Another reason for the large number of busy signals is that the department reduced the number of operators who answer telephone calls from consumers. For nine months in 1985, the department used three operators in the Los Angeles office to answer telephone calls. The chief of the Consumer Services Bureau stated that the number of operators was reduced because of limited funds. Currently, the department employs one full-time and one part-time operator who are skilled in responding to insurance questions.

Finally, the number of telephone calls received by the department has increased significantly. In 1984, the department answered over 78,000 telephone calls. In 1985, the department answered over 100,000 telephone calls from consumers. This represents an increase of over 28 percent.

The Department Does Not Have Toll-Free Telephone Lines

Although at least 20 other state agencies operate toll-free telephone lines to serve the public, the department does not have toll-free telephone lines for consumers to request assistance in

resolving insurance problems. Several of the 20 state agencies with toll-free telephone lines to assist the public reported that their toll-free telephone lines have improved their accessibility and their service to the public. For example, the Department of Justice reported that the toll-free lines improved the public's statewide access to government. The Department of Justice also reported that the toll-free telephones benefited consumers who had been involved in fraudulent activities. In addition, the Bureau of Automotive Repair, within the Department of Consumer Affairs, reported that the toll-free lines are an integral part of its statewide service to the public, and that the toll-free lines have improved its effectiveness in handling consumer complaints involving the 40,000 automotive repair shops located throughout California.

In our questionnaire sent to consumers, we asked if the consumers had incurred a toll charge. Eighty-three percent of the consumers responding to our questionnaire reported that they had incurred a toll charge when they telephoned the department. However, the department has not installed toll-free telephone lines because of the lack of funds to pay for the lines.

Corrective Action

To improve its processing of complaint investigations, the department has taken several corrective actions. First, the department appointed three new managers in the Consumer Affairs Division. The

department hired a new chief for the Consumer Affairs Division in July 1985. The department appointed new bureau chiefs for the Consumer Services Bureau in September 1985 and the Policy Services Bureau in March 1986. Many of the problems we identified occurred before the appointment of the new management.

In March 1986, the division issued new procedures for routing incoming complaints to the appropriate bureaus. These new procedures clarify each bureau's responsibilities for handling each type of complaint received.

Furthermore, the new chief of the Consumer Services Bureau instituted actions to correct deficiencies in processing complaints. For example, the Consumer Services Bureau established clerical positions in both the San Francisco and Los Angeles offices to eliminate delays in processing correspondence on complaints. The new bureau chief presently is reviewing complaint investigation files to ensure that bureau staff are processing complaints promptly. The new bureau chief also developed a training manual for new employees to use. Further, the bureau chief took the action necessary to ensure that all complaints were returned to the proper office for processing. Finally, the Consumer Services Bureau received Department of Finance approval to hire four temporary clerical staff through June 30, 1986, to assist in the processing of complaint investigations.

At the Rate Administration Bureau, new investigative staff were hired or were transferred from within the department to work on the backlog of complaints. Further, the Rate Administration Bureau has hired a clerical person to assist the investigative staff. The bureau chief provided training to the new staff which should alleviate some processing delays; he also established procedures to monitor each worker's caseload.

At the Investigation Bureau, the Los Angeles office is reviewing the list of backlogged complaints to ensure that the list is accurate and up-to-date. In addition, the Investigation Bureau stated that it has obtained authorization to pay for overtime and temporary help for fiscal year 1986-87 to reduce the backlog.

CONCLUSION

The Department of Insurance was slow in processing at least 7,025 consumer complaints (51 percent) filed against insurance companies. As a result, the public did not receive prompt protection from unfair insurance practices. Furthermore, when consumers filed complaints against the insurance industry, the Investigation Bureau did not process the complaints promptly, so a backlog of 367 complaints (32 percent) exists. Because of this backlog, alleged misconduct of insurance agents and brokers is not being investigated. Complaints were not processed promptly because of increasing caseloads, inadequate

supervision, a high turnover of staff, the lack of updated procedures, and problems of routing complaints among the three bureaus.

In addition, consumers have limited access to the department. The department has insufficient telephone lines and operators and no toll-free telephone lines. A telephone company's survey disclosed that consumers phoning the Los Angeles Branch received busy signals over 7,000 times during the week of March 17, 1986. As a result, consumers have difficulties in contacting the department to request assistance in resolving their complaints. Other state departments serving the public have proportionately more telephone lines and operators to handle the telephone calls they receive.

RECOMMENDATIONS

In addition to the actions already taken by the Department of Insurance to more promptly process consumer complaints, the Department of Insurance should direct its Consumer Affairs Division to take the following actions:

- Increase the staffing (permanent or temporary) in each of the bureaus to assure that there is sufficient staff to process the increasing number of complaints. The department should prepare the necessary budget change

proposals for legislative consideration if the department determines that additional staff are needed beyond those that could be transferred from other department activities.

- Develop procedures manuals for investigating complaints, including detailed descriptions for handling each step of the complaint resolution process. These manuals should be provided to bureau employees so that the employees have accurate and updated information on the proper methods for investigating complaints. Furthermore, the procedures manuals should be periodically updated with current information.

- Monitor the pending complaint investigations at least monthly to identify complaints that are not investigated promptly. In these complaints, the supervisors in each bureau should ensure that appropriate actions are taken to expedite the resolution of complaints. Further, the supervisors should ensure that the complaint investigations are being processed in accordance with legal and departmental requirements.

- Review the new complaint routing procedures to ensure that incoming complaints are directed to the appropriate bureau for processing.

To eliminate the backlog of complaints in the Investigation Bureau, the department should direct this bureau to do the following:

- Develop an accurate and up-to-date listing of pending complaint investigations.

- Review the current workload, including the listing of pending complaint investigations, to determine if staffing in the Investigation Bureau is sufficient to promptly process the workload. The Investigation Bureau should consider the effectiveness of its recently hired staff in the Los Angeles office before determining if additional staff are needed. If the department determines that additional staff are needed, the department should prepare the necessary budget change proposals for legislative consideration.

To increase the public's ability to request assistance from the department in resolving insurance disputes, the department should direct the Consumer Affairs Division to do the following:

- Install additional telephone lines and hire additional operators to receive telephone inquiries from consumers. The department should obtain assistance from a telephone

company in determining the number of telephone lines to be installed and the number of operators needed.

- Consider requesting funds from the Legislature to pay for the installation of statewide toll-free telephone lines to receive complaints and inquiries from consumers.

- Monitor the complaint telephone lines at least quarterly to determine if existing telephone lines are sufficient to receive complaints from the public.

CHAPTER II

THE DEPARTMENT OF INSURANCE'S REVIEW OF COMPLAINTS AGAINST INSURANCE COMPANIES

The department's Market Conduct Bureau is not effectively using its staff to identify companies with deficient operations. For example, in 1984 the bureau reviewed one company whose complaint record had improved by 10 percent over the previous year. During this time, 36 companies with worse complaint records were not reviewed. Further, the bureau continues to conduct comprehensive reviews of companies even though no deficiencies are found. As a result, the bureau spent 60 percent of its time reviewing five insurance companies for which no deficiencies were identified. This staff time could have been more productively spent reviewing insurance companies with poor complaint records. In addition, the bureau did not coordinate its reviews with the department's Field Examination Division which also conducts market reviews as a part of its ongoing financial audits.

In addition, the department, in an attempt to rank automobile insurance companies, issued a report that incorrectly ranked the companies. The report was incomplete because the department omitted companies with less than three complaints. Further, the department made several errors when ranking insurance companies.

The new chief of the Consumer Affairs Division intends to thoroughly review the market conduct operations and to make appropriate changes in the methodology and scope of the market conduct reviews.

THE MARKET CONDUCT BUREAU DID NOT CONDUCT EFFECTIVE REVIEWS OF INSURANCE COMPANIES

The California Insurance Code authorizes the department to conduct reviews of insurance companies when the department deems it necessary. Since it was established in 1983, the Market Conduct Bureau has reviewed ten insurance companies to determine if deficiencies exist and to recommend improvements to companies for correcting the deficiencies found.

Ineffective Selection of Insurance Companies

In 1985, the staff of the Market Conduct Bureau consisted of four employees. However, because of death and illness, the bureau had only two employees as of March 1986. Although the bureau's staff is limited, it is not effectively using its resources to identify deficiencies in the operations of insurance companies. For example, the bureau reviewed one company with a relatively good complaint record while 36 insurance companies with worse complaint records were not reviewed. In addition, in 1984, consumers filed over 200 complaints against one of the companies that was not selected for a market conduct study. These 200 complaints represented an increase in complaints of 23 percent from the previous year. However, a company that received 10 percent fewer complaints in 1984 than it did in 1983 was selected for a market conduct study. After completing the market conduct reviews, the bureau found no deficiencies in the operations of this company.

In addition, in selecting insurance companies for a market conduct review, the bureau did not coordinate its activities with the department's Field Examination Division, which also performs market conduct reviews of insurance companies as a part of its financial audits of insurance companies. In 1984, the bureau reviewed one company that the Field Examination Bureau had examined during the same year. Moreover, the bureau reviewed another two companies that had been reviewed by the Field Examination Division within one year of the bureau's review.

Furthermore, the Market Conduct Bureau used its limited staff to review five companies, including the one company with an improved complaint record, for which it found no deficiencies. The bureau spent nearly $190,000 (which was later recovered from the insurance companies) and over 60 percent of its time reviewing these five companies. However, if the bureau had conducted a preliminary evaluation before completing each of the five reviews, the lack of deficiencies would have been revealed and the bureau could have begun reviews of other companies.

Reasons for Ineffective Reviews

The two employees who were primarily responsible for the Market Conduct Bureau's operations are deceased. Since the department records do not explain why the bureau used its limited staff in unproductive reviews, the department's officials cannot determine why

the reviews were conducted. Furthermore, even though the bureau has a procedures manual, its staff do not use the manual. When we contacted the bureau's staff, they stated that they were not aware of the manual. For example, the staff were not aware that the manual stated the bureau must concentrate its effort on prevalent unfair practices in insurance companies. Without using the manual, staff are not aware of the department's objectives and procedures in reviewing an insurance company's operations effectively.

Corrective Action

The new chief of the Consumer Affairs Division recognized the operational deficiencies in the bureau. To correct these deficiencies, the chief consolidated the Market Conduct Bureau with the Policy Services Bureau, which is under new management. Under the Policy Services Bureau, the chief intends to thoroughly review the market conduct operations and to make appropriate changes in the methodology and scope of the market conduct reviews. Recently, the Market Conduct Bureau and the Field Examination Division began to coordinate their reviews of insurance companies.

THE DEPARTMENT OF INSURANCE'S RANKING OF AUTOMOBILE INSURANCE COMPANIES IS INCOMPLETE AND INACCURATE

In January 1986, the department issued its first report ranking automotive insurance companies using the information from

complaints filed against the companies. The report was the department's first effort to provide meaningful complaint information on automobile insurance to the public. The department's report should be beneficial to consumers, who pay over $5.6 billion of automobile insurance premiums annually. In issuing the rankings of automobile insurance companies, the department cautioned consumers against placing too much credence in complaint data as a sole measure of a company's performance. The department stated that there are many factors to consider in evaluating an insurance company, such as the cost of insurance coverage.

The department prepared the report ranking automobile insurance companies under the authority of Section 12921.3 of the California Insurance Code. This section requires the department to provide for the education and dissemination of information to the public. In providing educational information to the public, the department should ensure that the information is accurate and complete.

In its report, the department ranked 96 automobile companies using both complaint and premium information. The department divided the insurance companies into three groups based upon the premiums for automobile insurance earned by the insurance companies. The five largest companies with premiums of over $500 million each were ranked in the first group while 26 companies with earned premiums from $20 million to $500 million were ranked in the second group. The department ranked the remaining 65 insurers with premiums of less than $20 million in the third group.

The Report Contains Inaccurate and Incomplete Information

To determine the rankings for each of the 96 companies in its report, the department used the ratio of the number of justified complaints per million dollars of premiums. However, the department has not clearly defined a "justified complaint." The report defines a justified complaint as the automobile insurance company's improper denial of a claim, unsatisfactory settlement offer for a claim, or delay in processing a claim. The manual defines a complaint as justified when the complainant has a "legitimate and valid reason" in seeking assistance from the department.

Using the manual's definition of a justified complaint, we determined that 10 percent of the complaints in our sample of 88 complaints were incorrectly recorded: complaints that were recorded as justified, according to the manual's definition, should have been recorded as unjustified and vice-versa. In addition, the information in the report was incomplete because the department excluded over 220 companies that had received fewer than three complaints that were justified, according to either the manual's definition or the report's definition. As a result, over 150 companies with the best rankings in their respective premium groups were not included in the report.

The department also made errors in determining the ratios used to rank the insurance companies. For example, the department recorded the premium amounts incorrectly for eight insurance companies. For one

company, the department understated premiums by approximately $8.5 million; as a result, the company was inaccurately ranked lower than other companies. This and the other types of errors affected the rankings of 32 of the 65 companies with an earned premium of less than $20 million.

Effects of Incorrect Rankings

After we discovered the department's omissions and inaccuracies in ranking automobile insurance companies, we recalculated the complaint ratios for each automobile insurance company. We found that the rankings of the companies changed significantly for companies with premiums under $500 million. For example, among the companies in the second group (premiums of $20 million to $500 million), five companies were omitted from the department's rankings. Three of these five companies would have ranked within the top eight companies in this premium group. Among the third group of companies (premiums under $20 million), 219 additional companies would have been added to the rankings; 154 of these companies would have ranked higher than any of the originally ranked companies. Therefore, the department omitted companies with the best complaint ratios from the report.

By relying on the department's report, consumers may have been improperly influenced in selecting insurance companies. Furthermore, insurance companies may have lost customers who selected insurance companies based on the rankings contained in the department's report.

CONCLUSION

The Department of Insurance is not effectively using consumer complaints to review insurance companies. The department's Market Conduct Bureau is not effectively using its staff to identify companies with deficient operations. The bureau reviewed a company with an improved complaint record while companies with worse complaint records were not being reviewed. Also, the bureau continues to conduct comprehensive reviews of insurance companies even though no deficiencies are found. The bureau also does not coordinate its reviews with the Field Examination Division, which conducts similar market reviews as a part of its ongoing financial audits.

In addition, the department issued a report that ranked automobile insurance companies incorrectly. The report was incomplete because the department omitted companies with less than three complaints. Furthermore, the department made several errors when ranking the insurance companies.

RECOMMENDATIONS

In order to identify insurance companies with deficient operations, the Department of Insurance should direct its Market Conduct staff to do the following:

- Select only those insurance companies with complaint records or practices that indicate a need for a market conduct examination.

- Terminate a market conduct review if the preliminary results of the review indicate that the insurance company is operating properly. In these situations, the staff should select another company for a market conduct review.

- Continue to coordinate the market conduct reviews with the Field Examination Division.

To improve the usefulness of future reports on the ranking of insurance companies to the consumers, the Department of Insurance should direct its Consumer Affairs Division to take the following actions:

- Include in its analysis all relevant complaint information from available sources.

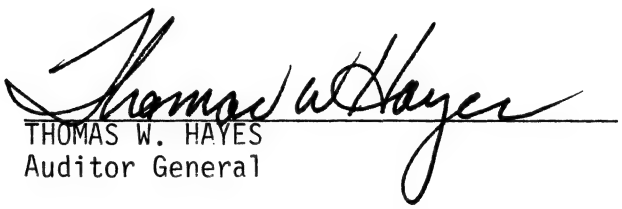
- Review all information to ensure that the reported information is reliable and accurate. The data should be reviewed by each of the bureaus that developed the data to ensure the accuracy and completeness of the data.

- Develop consistent definitions of justified and unjustified complaints for use by division personnel. The definitions should be included in the procedures manual.

- Monitor case workers to ensure that the complaints are properly classified as justified or unjustified.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



THOMAS W. HAYES
Auditor General

Date: May 12, 1986

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DEPARTMENT OF INSURANCE
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LOS ANGELES, CALIFORNIA 90005
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May 7, 1986

Mr. Thomas W. Hayes
Auditor General
State of California
600 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Hayes:

Secretary of Business, Transportation and Housing, John Geoghegan has asked that I respond to your report entitled "The Department of Insurance Should Be More Responsive to Consumer Complaints Against The Insurance Industry."

As Insurance Commissioner, I have instructed my staff to prepare responses to criticism contained in each section of your report.

Should you desire additional information, please contact my chief deputy, Roxani Gillespie at (415) 557-3245.

I thank you for the opportunity to comment.

Sincerely,

BRUCE BUNNER
Insurance Commissioner

BB:cs
cc: Mr. John Geoghegan
Secretary
Business, Transportation & Housing

DEPARTMENT OF INSURANCE RESPONSE

TO THE MAY, 1986 REPORT

OF THE OFFICE OF THE AUDITOR GENERAL

REGARDING THE EXAMINATION OF

THE DEPARTMENT OF INSURANCE

CONSUMER AFFAIRS DIVISION AND INVESTIGATION BUREAU

TABLE OF CONTENTS

INTRODUCTION

Since the insurance industry in recent years has been in the grip of a drastic pricing and underwriting cycle, the Department of Insurance has had to take substantial measures to stay abreast of the industry it regulates.

In the past 12 months, the Department of Insurance Consumer Affairs Division has been reorganized under new leadership with a new Division Chief and two new Bureau Chiefs. There has been a reallocation of staff along with staff additions, revised workflow procedures, a renewed emphasis on training, a redirection of company rate examinations, and enhanced computer utilization. The Department of Insurance is a proactive organization aggressively responding to the challenges posed by the extremes of the insurance cycle.

With the increasing consumer awareness of insurance and its importance in the marketplace, the Department welcomes all constructive comments as presented by the Auditor General as to how we might increase our operating efficiency and effectiveness.

The Auditor General's Report includes considerable comment about three non-mandated activities of the Department, namely, market conduct, complaint ratios, and consumer services. Each of these activities, among others, were self-initiated by this administration. While the comments of the Auditor General have merit, we are nevertheless deeply disappointed that their report does not acknowledge the positive direction and usefulness of these self-initiated activities to better serve the consumer. (1) *

*The Auditor General's comments on specific points contained in the department's response begin on page 63.

SUMMARY

1. The Department of Insurance is responding successfully to an increase in complaint workloads

The extension in time required to satisfactorily resolve complaints was the direct result of a dramatic rise in complaint activity in 1984-85 which continued into the 1985-86 fiscal year. Since there was a relatively sudden turn around in the insurance industry pricing cycle, complaint activity at the Department of Insurance increased dramatically in all areas but particularly in the area involving the availability/affordability of coverage (over one thousand percent rise in complaints involving availability of coverage, for example). Given this sudden expansion in complaint activity, the Consumer Affairs Division has responded in a number of areas to maintain service to the insurance buying public. Specifically, there has been a renewed emphasis on training, reallocation of staff, better organization, enhanced computer utilization, and improved workflow procedures and workflow monitors. Through cohesive management direction, the Consumer Affairs Division is responding effectively to the challenge without many costly additions to staff.

At a time when our service was poorer than it is today, an independent public opinion poll conducted by the Auditor General shows that we were perceived by our customers, the insurance buying public, as an effective complaint handling agency. Over two-thirds of the respondents said that the Department was conducting its investigations in a prompt manner. On another question, over two-thirds of the respondents said that they would use the Department again to resolve a complaint.

While the Department has not always succeeded in meeting its own tough performance standards, the true indicator of effectiveness, the judgement of the insurance buying consumer, indicates that we are doing a credible job.

2. The Department of Insurance has acquired additional funds to eliminate the backlog of complaints that have not been investigated

Department and Bureau management have previously initiated various programs to reduce the magnitude of the backlog of cases to be investigated and alleviate any adverse impact on the public. The Department has authorized temporary and overtime funds for the Bureau during FY 86-87 to further reduce, and hopefully eliminate the backlog.

Nonetheless, the Department believes that it is important to put this backlog in its proper perspective in relation to the overall enforcement activities of the Investigation Bureau.

During 1985 the department's Investigation Bureau investigated and completed 2,872 reported cases of illegal activity in the insurance business, including 798 complaints. As a result of these investigations, files on 626 agents, brokers insurance companies and others were sent to the department's Legal Division for action to either discipline the violators or otherwise remove them from the insurance business. During the course of these investigations, the bureau recovered $476,811 for insurance consumers.

The bureau received 914 new complaints for investigation during 1985. 77% of these new complaints were assigned to an investigator for investigation within 13 days. Overall, 58% of the investigation assignments opened in 1985 were completed within 43 days.

The Investigation Bureau's prompt and effective investigative action in the majority of cases has protected countless consumers against the misconduct and illegal acts committed by unscrupulous agents, brokers and companies.

For example, during 1985 Bureau investigators identified an unlicensed agent in the Los Angeles area who was selling bogus auto insurance policies to residents of the Hispanic community. Bureau investigators uncovered this scam before any consumer complained to the Department and, as a result, the Department was able to issue a news release to alert consumers before they suffered uncovered losses and before additional consumers could be swindled.

3. The Department of Insurance is improving telephone access to its complaint facility

In an effort to improve quality phone access to consumers without a negative impact on availability of this service, an insurance policy officer with over twelve years of telephone experience was given primary responsibility of handling consumer phone queries. At the same time, an additional employee was hired and trained to assist the more experienced examiner.

As the Department of Insurance has become more visible through media contacts, the complaint ratio study, a private passenger auto price guide, and consumer brochures, the demand for our services has increased more rapidly than expected. The most recent busy signal study (as contrasted with our study, conducted by Pacific Telephone, of May, 1985, which showed 4.5 average busies per day) reflected this increase in the Consumer Affairs Division's popularity.

It is our plan to continue to increase our phone handling capability with quality, trained people. As of this date, the Consumer Services Bureau has added two additional people to work on the phones and training is taking place. In addition, plans are being considered to add a toll-free 800 number to better serve the public.

4. The Market Conduct Bureau is being reorganized to strengthen Market Conduct Examinations

The Market Conduct Bureau has been incorporated into the Policy Services Bureau under new management to help add direction and leadership. Concurrently, there are plans to enhance the staff of this bureau to strengthen these important claims field examinations. Coordination and communication between the new Chief of the Policy Services Bureau and the field examination division Chief has already taken place to better define the role of the Market Conduct Examination as it pertains to each operation. In the past, contrary to commentary by the Auditor General, there have been clear and consistent reasons for conducting Market Conduct Examinations. While complaint frequency has been one determinant, there have been other reasons as well for conducting these examinations.

The Auditor General's concern regarding lack of deficiencies on a given exam is not grounds for not conducting the examination as long as there are tangible reasons for our being there. (2) The fact that problems were not found on a given exam could be indicative of a need for more training on the part of examiners, which is currently being assessed by the new Policy Services Bureau Chief.

5. The Department of Insurance complaint ratio study was effective

The Department of Insurance does not agree with the Auditor General regarding their conclusions on this study.

The complaint ratio study, the first one of its kind ever done by the Department of Insurance, was deliberately shortened to facilitate distribution to a wide number of consumers through the media.

The alleged inconsistency of classification of complaints between justified and unjustified was an incorrect conclusion on the part of the Auditor General's staff. The Policy Service Bureau has established guidelines in this area which it consistently follows. In a small number of cases there is room for variation of opinion due to subjective interpretation. As best as we can tell, the genesis of disagreement between the Department of Insurance and the Auditor General was on these few cases. (3)

CHAPTER I

THE DEPARTMENT OF INSURANCE'S PROCESSING OF CONSUMER COMPLAINTS

THE DEPARTMENT OF INSURANCE IS RESPONDING SUCCESSFULLY TO AN INCREASE IN COMPLAINT WORKLOADS

Due to the crisis in the insurance market place in 1984-85, and continuing into 1985-86, the department experienced a drastic increase in consumer complaint volume. The increase ranged from 72% to 1,072% when comparing the monthly figures of 1985 vs 1984.

Recognizing the continuing increase in complaint activity, the Department has taken corrective action to increase the staffing in the complaint investigation area. The authorized staff in the Rate Administration Bureau has increased from 3 in January 1984 to 7 in July 1985. In addition, management temporarily transferred a team of three rate analysts from another program. The chief of the Rate Administration Bureau also implemented a work flow monitoring system to monitor the workflow and pending complaint workload.

The allegation that the Department is slow in processing complaints is not accurate.(4) The nature of complaints vary significantly from case to case. Some complaints could be resolved within a 30-day period and some need an extended period of time to be resolved. Due to the crisis in the insurance market place, the volume of complex complaints increased dramatically. First came the problem of mid-term cancellations, then the availability of child care liability insurance, ice skating rink liability insurance and certified midwife liability insurance problems. For example, during the audited period, the Rate Administration Bureau received a substantial number of complaints involving Workers Compensation dividend issues. The issues are complex and usually require more than 120 days to complete a thorough investigation.

After September, 1983 as the Consumer Service Bureau was being developed, four experienced Insurance Policy Officers were assigned to the bureau. In addition, qualified clerical employees were selected to train within the bureau as a part of

the department's upward mobility program, the intention being to develop these employees to the Insurance Policy Officer level. In order to do so, some delays in processing did occur during the 1984-85 period covered by the audit as one half of the staff was being trained to handle consumer complaints.

In September, 1985, new bureau management began evaluating the work flow and work product of the bureau. It was determined that most delays in the timeliness of complaint handling were caused by the lack of clerical support.

An additional clerical employee was added to the LA office and another in the SF office in January, 1986. In February, 1986, work began on a budget deficiency in order to hire additional clerical employees in both offices. These positions were approved, and the new employees are being trained. This additional staffing will make it possible for the Consumer Services Bureau to more effectively assist the consumer by providing efficient and accurate telephone information as well as timely correspondence. Overall the bureau will be reducing the amount of time to process consumer complaints.

Two additional word processing terminals have also been ordered, one for San Francisco, and one for Los Angeles, in order to more efficiently complete consumer and company correspondence.

Unjustified criticism was directed toward the department with respect to the "slow" processing of consumer complaints. The mere statements that "the department was slow to process at least 7,025 (5%) complaints , that the average time to process complaints was eighty-nine (89) days and that the public did not receive prompt protection from unfair insurance practices" is misleading. A variable completely ignored was the complex and/or technical issues involved in complaint cases which often necessitated files being opened and monitored for many months. In fact, there are occasions where well handled files are properly kept open in excess of one year. The Auditor General's report portrays a distorted picture of service to the consumer by utilizing straight statistics without consideration to other important influencing variables, such as the quality of their service. (5)

The conclusion made by the Auditor General that consumers are not effectively protected is not accurate.(6) In reviewing the Auditor General's survey of consumer opinion about the Department's service, over 2/3 of those responding agree that the Department has conducted its investigations promptly. Over half of those responding are satisfied with the Department's processing of complaints, and over 2/3 would use the Department's service again. Furthermore, during the audited period (1984-85) the department has recovered a total of 12 (twelve) million dollars for the consumers. The total dollars of recovery are shown as follows:

Fiscal Year	PSB	RAB	CSB	Total
1983-84	$11,343,746	$439,443	$76,643	$11,859.832
1984-85	11,286,450	$170,010	$544,472	$12,000,932

THE DEPARTMENT OF INSURANCE HAS ACQUIRED ADDITIONAL FUNDS TO ELIMINATE THE BACKLOG OF COMPLAINTS THAT HAVE NOT BEEN INVESTIGATED

The backlog of 367 complaints in the Investigation Bureau is of concern to the Department of Insurance. As noted in the auditor's report, Department and Bureau management have previously initiated various programs to reduce the magnitude of this backlog and alleviate any adverse impact on the public. As further noted in the auditor's report, the Department has authorized temporary and overtime funds for the Bureau during FY 86-87 to further reduce, and hopefully eliminate the backlog.

Nonetheless, the Department believes that it is important to put this backlog in its proper perspective in relation to the overall enforcement activities of the Investigation Bureau.

The Investigation Bureau is the law enforcement arm of the Department of Insurance. As such, the Bureau is charged with the responsibility of enforcing the insurance laws in the State of California and protecting the public from economic loss and distress caused by violations of those laws. To fulfill this responsibility, the Bureau performs three major functions:

1. The Bureau screens and investigates applicants for licenses in accordance with statutory eligibility requirements including evaluation of criminal and character backgrounds. Applicants include persons and entities filing for licenses to act as life and disability agents, life and disability analyst, fire and casualty agents, fire and casualty brokers, solicitors, surplus line brokers, bail bondsmen, travel agents, stock agents, administrators and insurance adjusters.

2. The Bureau conducts investigations of existing licensees and others connected with the business of insurance to assure compliance with the applicable statutes and regulations. Bureau investigators gather and evaluate facts from insureds, insurance companies, producers, and others; interview witnesses and interrogate subjects; inspect and audit books, accounts and records; and maintain a computer data bank of information on current and past perpetrators.

3. The Bureau submits detailed reports of investigation with accompanying evidence to the Department's Compliance Bureau to facilitate disciplinary action against those persons and entities who have violated the law. Pursuant to section 12928 of the Insurance Code, criminal violations are referred to the appropriate district attorney for prosecution.

Violations of insurance laws are reported to the Bureau by various sources, such as, law enforcement agencies, regulatory agencies, insurance companies, insurance producers, confidential informants, the news media, insurance consumers and others. Approximately one-third of the investigations are initiated as a result of potential violations reported by insurance consumers/policyholders.

During 1985 the department's Investigation Bureau investigated and completed 2,872 reported cases of illegal activity in the insurance business, including 798 complaints. As a result of these invesgiations, files on 626 agents, brokers insurance companies and others were sent to the department's Legal Division for action to either discipline the violators or otherwise remove them from the insurance business. During the course of these investigations, the bureau recovered $476,811 for insurance consumers.

The bureau received 914 new complaints for investigation during 1985. 77% of these new complaints were assigned to an investigator for investigation within 13 days. Overall, 58% of the investigation assignments opened in 1985 were completed within 43 days.

The Investigation Bureau's prompt and effective investigative action in the majority of cases has protected countless consumers against the misconduct and illegal acts committed by unscrupulous agents, brokers and companies.

The Public is Protected Against Improper Conduct

One of the most effective consumer protection activities of the Investigation Bureau is to identify and stop illegal activity before consumers are victimized. Many of the investigations in this area are initiated as a result of information generated internally from intelligence gathering of from sources other than insurance consumers directly. These types of investigations were not included in the Auditor General's audit of the Bureau. Yet, as illustrated by the following examples, these types of cases have a significant impact on consumer protection. In 1985, the Bureau developed information indicating that an agent in the Los Angeles area was selling phoney insurance to apartment house owners.

The Bureau immediately began an investigation, identified victims, and then shut down the phoney scheme before additional consumers were victimized. These apartment house owners were exposed to a potential uncovered loss of $72.4 million in property coverage and $219 million in liability coverage. Additionally, these consumers were bilked out of more than $122,000 in premiums for the fake insurance policies. One can only imagine how many other consumers would have been similiarly victimized had the Bureau not identified and stopped this scam promptly.

Another example involves an unlicensed agent in the Los Angeles area who was selling phoney auto insurance to the Hispanic community. Bureau investigators uncovered this scam before any consumers complained to the Department, and, as a result, the Department was able to issue a news release to alert consumers before they suffered uncovered losses and before additional consumers could be swindled.

Both of these cases had major ramifications for the insurance-consuming public at large. The Department's

expeditious and effective handling of these 2 major cases clearly illustrates that the Department responds promptly to protect insurance consumers against improper and fraudulent insurance practices.

As of December 31, 1985 the Investigation Bureau had 1,151 complaints cases pending. The auditor's report states that these complaints were "unresolved". Actually, 784 of these complaints were in various stages of being investigated; and many of these had proceeded to near completion with the consumer's complaint having been resolved. It is quite common for the investigative process to continue long after the consumer's complaint has been resolved because of other regulatory or investigative issues.

While it is true that 44 complaints over 2 years old had not been investigated as of 12/31/85, it is nevertheless significant to note that these 44 complaints constitute only 2% of the total complaints received by the Bureau during that 2 year period.

The auditors state that "the Investigation Bureau did not have an up-to-date list of backlogged complaints." This is not an accurate statement of the facts. The Bureau did and does have a list of backlogged complaints for each of the Bureau's 4 offices. Each office, except Los Angeles, had an accurate up-to-date list during and prior to the auditor's visit. The few erroneous entries on the list for Los Angeles were in the process of being corrected when the auditors questioned the list. The few erroneous entries did not have any measurable affect on Los Angeles' ability to manage the backlog. (7)

THE DEPARTMENT OF INSURANCE IS IMPROVING TELEPHONE ACCESS TO ITS COMPLAINT FACILITY

In May, 1985, the telephone company conducted a busy study of the Consumer Service Bureau's telephone lines. This study was conducted over a two week period, and resulted in an average of 4.5 busies per day. At the time the bureau had 2 employees answering the phones throughout each day. These employees were temporary, and there was a lack of quality in the manner in which they handled consumer calls. When funding ran out in December of 1985, bureau management decided to assign an experienced Policy Officer, with more than twelve years of

consumer telephone experience, to handle the consumer lines. A second permanent employee was hired and trained to assist the Insurance Officer. This was a move to increase the quality of telephone assistance to consumers.

Although the busy study conducted in March, 1986 showed a dramatic increase in busies, this should not be misconstrued to mean that those busies represent unassisted consumers. It should be assumed that any time a caller gets a busy signal, they will redial any number of times. In addition, the department has other phone numbers listed through-out the four offices in the state that the consumer can call in order to access additional phones within the Consumer Service Bureau.

The department has requested additional busy studies to be conducted on an ongoing basis for the next six months to determine if the additional staffing is adequate or if the staffing needs will reduce after the current insurance "crisis" has subsided.

The department will address permanent staffing needs based on a thorough evaluation of the work load consistency.
In addition, the department is working with Pacific Telephone to determine the feasibility of an 800 number.

CHAPTER II

THE DEPARTMENT OF INSURANCE'S REVIEW OF COMPLAINTS AGAINST INSURANCE COMPANIES

THE MARKET CONDUCT BUREAU IS BEING REORGANIZED TO STRENGTHEN MARKET CONDUCT EXAMINATIONS

The Auditor General's office could not determine why Market Conduct Examinations were conducted.(8) Their failure should not be construed as to the non-existence of reasons. In fact, comparisons of complaint ratios, analyses by officers of types of complaints, feedback from other bureaus as well as other very definitive factors are utilized in determining who gets examined. In short, there are consistent reasons why Market Conduct Examinations are conducted. There was only one (1) company examined that the department cannot explain why and that is because both decision makers are deceased and the records are incomplete.

A second criticism directed towards Market Conduct was that the reports were ineffective in their failure to find any deficiencies. This is basically a problem in training, education and experience. Market Conduct is still in its infancy having been established less than two (2) years ago. Reorganization has put it under the auspices of Policy Services Bureau and a new manager who is currently looking at present market conduct procedures fully intending to implement any changes necessary. New ideas have already been introduced and implemented into the Market Conduct Examination process. Furthermore, additional staffing is currently underway which should facilitate greater quantity and quality of Market Conduct Examinations.

The fact that nothing is found in the preliminary investigation is not grounds for a superficial review or a halting of the examination.(9) It is more indicative of a need for more training. This will transpire under new management as additional staff is hired. In addition, the fact that nothing is found in the preliminary investigation does not preclude the possibility that further investigation or review will turn up significant findings. Furthermore, our mere presence in the conducting of the examination is of significant value.

The criticism concerning Market Conduct's failure to coordinate its activities with the department's Field Examination Division, has been rectified. One recently completed examination and another in the process of being set up involved coordination and communication between the divisions. This coordination and communication will continue.

THE DEPARTMENT OF INSURANCE COMPLAINT RATIO STUDY WAS EFFECTIVE

The criticism of the personal lines auto complaint ratio study concerning incomplete information is without merit.(10) It was the department's conscious decision to omit those companies with 0-2 complaints the reasons being threefold:

1. Practically - it would be unwieldy to list over six hundred (600) companies most of which had only 0-2 complaints.

2. Utility - the report as submitted was much more amenable to publication, distribution and utilization by the media and the consumer.

3. De Minimis - such a low complaint record would not impart useful information to the consumer.

This study and report was the very first of its kind for this department and was in response to the growing consumer demand for this kind of information.

The reference of the department having "two different definitions of what constitutes a justified complaint" is incorrect.(11) The procedures manual, which is adhered to by all of the complaint handling officers, has a definition which is not inconsistent with the report's definition of a justified complaint. In fact, the procedures manual refers to other kinds of justified complaints including complaints justified with a "question of fact" along with those "when the complainant has a legitimate and valid reason in seeking assitance from the department". However, to go into detail in the report in attempts to clarify to the public what "justified, question of fact" means would be an exercise in futility. Both kinds of justified complaints were counted in the study.

With regard to the justifiability ratings used in the complaint ratio study, the Auditor General's office incorrectly pointed to inconsistences. It initially concluded that approximately twenty percent (20%) errors were made. Policy Service Bureau employees were requested to provide written responses to their specific findings and this figure was consequently reduced to approximately nine percent (9%). Even this nine percent (9%) error factor is questionable as time constraints on the part of a specific Auditor General employee did not permit adequate review, discussion and resolution of the differences in opinion between Policy Services Bureau personnel and the auditor.(12)

CHAPTER III

RESPONSES TO RECOMMENDATIONS

GENERAL RECOMMENDATIONS

The Consumer Services Bureau currently has four temporary clerical positions. During the following months management will monitor the work flow/load in order to determine any future budget change proposals for permanent positions.

Increased technical staffing in the Policy Services Bureau is not needed. Better time management and the filling of one (1) of the vacancies may suffice to properly process the current and future numbers of complaints. Other staffing needs are being reviewed.

The Consumer Services Bureau procedures manuals will be updated and expanded to included more detail of the complaint process.

Procedures manuals for Policy Services and Market Conduct already exist although, admittedly, in need of updating. Management is new and as he becomes more familiar with current procedures and what needs to be done will implement the necessary changes and update the manuals accordingly.

The Rate Administration Bureau currently uses enforcement files and complaint coding procedures for its employees to process complaints. We will consolidate all existing manuals and procedures and make it a more formal procedure manual.

Pending complaint investigations are being monitored by monthly review of pending statistics and quarterly pulls of files that are more than one hundred twenty (120) days old.

The Chief of Rate Administration Bureau has implemented a weekly work activity monitor system to monitor the workflow and pending complaint cases every week.

The Consumer Services Bureau is training additional telephone operators in both offices. We will continue to monitor the situation to determine future needs.

The department is working with Pacific Telephone to determine the feasibility of an 800 number.

The department has requested a monthly busy study of the complaint telephone lines to determine if the volume is being handled properly.

MARKET CONDUCT RECOMMENDATIONS

It has been and continues to be our decision to select insurance companies for examination on the basis of several criteria, including but not limited to, numbers and ratios of complaints, kinds of complaints, recommendations by Insurance Policy Officers and recommendations by other Bureaus.

It would be incorrect to terminate a Market Conduct review if the preliminary results are indicative of a proper company operation. Superficial short reviews can be misleading. In addition, further digging may be necessary before even an experienced examiner uncovers significant findings.

Coordination with the Field Examination Division is already taking place.

COMPLAINT RATIO STUDY RECOMMENDATIONS

For reasons of practicality, utility and economy it is incorrect to include and analyze all relevant complaint information on all companies.

Future reviews of all information will be carefully done to prevent incorrect data resulting in incorrect rankings.

Consistent definitions of justified and unjustified complaints do exist for use by Policy Services Bureau personnel and are included in the procedures manual. As with almost any complex technical area there will always be room for some subjectivity.

Cases are monitored to insure that complaints are properly classified with respect to justifiability.

* * *

AUDITOR GENERAL'S COMMENTS ON THE DEPARTMENT OF INSURANCE'S RESPONSE

(1) We acknowledge the department's corrective actions and its improvements in managing the Consumer Affairs Division as described on page iv of the Summary and on pages 5, 19, 24, 25, 26, 27, 31, 34, and 35 of our report.

(2) The report does not state that a lack of deficiencies in a market conduct review means that no review should have been conducted. Our report points out, however, that the Market Conduct Bureau could have more effectively used its staff. Conducting preliminary evaluations before completing each review would have revealed a lack of deficiencies; the bureau could then have begun reviews of other insurance companies. (See page 33 of our report.)

(3) The department's response states that its definitions for justified and unjustified complaints are consistent. However, in the department's published list ranking automobile insurance companies, a justified complaint is defined as an improper action by an insurance company, while the department's manual defines a justified complaint as an action by a consumer. (See page 36 of our report.) Moreover, the staff responsible for analyzing data in the ranked list provided us with inconsistent interpretations of justified and unjustified complaints.

(4) The department states that it was not slow in processing complaints. We used the department's own guidelines for promptness to determine whether a complaint was slowly processed. (See pages 6 and 7 of our report.) In its response, the department contradicts its statement that complaints were not slowly processed. On page 7 of its response, the department discusses the reasons for its delays in processing complaints.

(5) As discussed in Comment 4 above, we used the department's own guidelines in determining that a complaint was slowly processed.

(6) The report does not state that the department is not effectively protecting the consumers. The report does state, however, that the department did not provide prompt protection from allegedly unfair insurance practices. We base this conclusion on the results of our review of a random sample of complaints received by the Consumer Affairs Division in fiscal year 1984-85. (See pages 11 through 15 of our report.)

(7) The department states that the Investigation Bureau has an up-to-date list of backlogged cases. However, as of December 31, 1985, the Investigation Bureau did not have an accurate list of backlogged cases. For example, the Investigation Bureau had not assigned an investigative priority to 4 complaints. Consumers had filed 3 of the 4 complaints before 1985. Also, the Investigation Bureau could not locate 8 (25 percent) of 32 complaint files we requested in the Los Angeles office. (See pages 19 and 20 of our report.)

(8) The department states that the Auditor General could not determine why market conduct reviews were conducted. We attempted to determine why the Market Conduct Bureau staff were utilized in unproductive work, but the department's records are incomplete, and the two employees who were primarily responsible for the bureau are deceased. (See pages 33 and 34 of our report.) Furthermore, in a letter to the Office of the Auditor General dated March 24, 1986, the Chief of the Consumer Affairs Division stated that he is "unable to determine exactly which and/or what considerations were weighed" in the two employees' decisions to conduct market conduct reviews.

(9) The department states that "the fact that nothing is found in the preliminary investigation is not grounds for a superficial review or a halting of the [market conduct] examination." As previously discussed in Comment 2, our report states that if the bureau had conducted a preliminary evaluation before completing each of the market conduct reviews, the lack of deficiencies would have been revealed and the bureau could have begun reviews of other insurance companies. (See page 33 of our report.)

(10) The department states that it deliberately omitted automobile insurance companies with fewer than three complaints from its ranked listing of automobile insurance companies. However, by omitting the companies with fewer than three complaints, the department excluded the companies with the best complaint records. For example, among the companies with premiums ranging from $20 million to $500 million, five companies (19 percent) were omitted from the department's rankings. (See pages 36 and 37 of our report.)

(11) A discussion of the definition of justified complaints is discussed in Comment 3.

(12) The department states that our report's conclusion that the 9 percent error factor in recording justified or unjustified complaints is questionable. Upon completion of our review, we determined that the error rate was actually 10 percent. The supervisor reviewed our results and agreed that 10 percent of the complaints from our random sample were incorrectly recorded. (See page 36 of our report.)

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps